

WALL STREET NATURAL GAS ANALYSTS SEE A BRIGHTER PRICE PICTURE FOR 2002

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U.S. producers may not have to wait for an economic rebound to push natural gas prices higher. Plummeting rig counts and high decline rates are expected to lead to a gas shortage that will brighten the price picture for 2002, according to two recent reports by Wall Street natural gas analysts.

At Morgan Keegan and Co., Subash Chandra and P. Donatello Pitts noted that recent storage injections of 23 billion cubic feet (Bcf) and 25 Bcf have been up to 2 Bcf smaller than anticipated. Although there are many variables that could be blamed - including rising industrial demand or bad data - Morgan Keegan believes that falling supply is the culprit. "We need a couple of more weeks of data before anything can be said definitively," the two analysts wrote. "If true, the collapse in commodity and sector prices may be abbreviated and a sector upgrade may occur earlier than anticipated."

There have been eight consecutive weeks of falling rig counts, Chandra and Pitts said. And third-quarter earnings statements from exploration and production companies indicate that production was declining well into the third quarter and likely has accelerated since.

"We are still surprised by the magnitude of the decline," the two analysts continued. "If true, production will continue to fall at rates exceeding our estimates and blunt the rate of growth in the storage surplus, supporting higher price levels."

Robert L. Christensen at FAC/Equities has slashed his 2002 U.S. natural gas rig count forecast by 35 percent, from 1,200 to 750 rigs. He expects U.S. wellhead deliverability to fall another 6 percent (3.6 Bcf a day) by the end of 2002 on top of a surprising decline of 2 percent in 2001, based on early third quarter reports.

"U.S. natural gas supply and demand could get very tight once again, even without help from an improved U.S. economy, in our view," Christensen said.

Based on the type of drilling that was occurring during the last drilling boom, Christensen sees a compressed reaction time between a cutback in drilling and a U.S. deliverability response. In 1999-2001, onshore drilling dominated. However, reserves per onshore gas well are generally about one-tenth the average of those of an offshore Gulf of Mexico shelf well, Christensen said. Plus, many of these wells were developmental wells, not exploration wells.

"U.S. gas exploration drilling never really got going, despite a reasonably long period of fairly high natural gas prices this past cycle," he maintained. "Exploration represented only 7 percent of all U.S. gas wells drilled over the past year. With such a limited attempt to find new fields and new potential gas-bearing geologic trends, there is very limited staying power from wells drilled in the 1999-2001 period."

On the demand side, Christensen expects U.S. gas demand in 2001 to be off only 4.4 percent despite the fact that key industrial demand (about 25 percent of total) is expected to be down 17.3 percent because of the weak U.S. economy.

Therefore, based on his 2002 wellhead deliverability scenario - down 2 percent by mid-2002 and 6 percent lower by the end of next year - it may not take much to bring demand and supply back into balance. "In fact, no additional de-

acceleration in the U.S. economy might be all that it would take," Christensen said

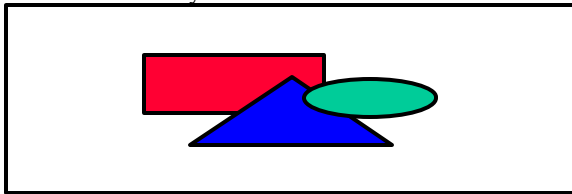
Furthermore, he believes that U.S. gas demand in 2002 will be up, possibly by 8.3 percent, led principally by a continued strong build-out in new gas-fired power plants.

Merchant power generators have more than 45,000 megawatts of new facilities planned for 2002. Using a very conservative estimate, Christensen believes 15,000 megawatts of this new generation will make it online by the middle of next year, which would potentially add more than 1.8 Bcf a day to incremental demand. For industrial demand, he assumes a 5.6 percent rebound off of depressed 2001 levels.

As U.S. gas rigs continue to stop working, the future price picture looks better and better. "When released on Friday afternoons, the Baker Hughes gas rig count may soon become to the 'gas bulls' what the American Gas Association weekly storage report on Wednesday afternoons was to the 'gas bears,'" he said.

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